STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

FOCAL COMMUNICATIONS CORPORATION OF ILLINOIS	)	
Petition for Arbitration Pursuant to Section 252(b) of the Telecommunications Act of 1996 to Establish an Interconnection Agreement with Illinois Bell Telephone Company d/b/a Ameritech Illinois	)	**Docket No. 00-0027**

SUPPLEMENTAL VERIFIED STATEMENT

OF

ERIC L. PANFIL

On Behalf of
AMERITECH ILLINOIS

March 6, 2000

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Eric L. Panfil. My business address is 2000 W. Ameritech Center Drive, Hoffman Estates, Illinois 60196.

Q. ARE YOU THE SAME ERIC L. PANFIL WHO SUBMITTED A VERIFIED STATEMENT EARLIER IN THIS PROCEEDING?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR SUPPLEMENTAL VERIFIED STATEMENT?

A. I will respond to the Verified Statements filed on February 28, 2000, by the ICC Staff.

Q. PLEASE IDENTIFY WHICH OF THE ISSUES RAISED BY FOCAL'S ARBITRATION PETITION THAT YOU WILL ADDRESS IN YOUR SUPPLEMENTAL VERIFIED STATEMENT.

A. I will address Issues 1 and 2.

<u>Issue 2</u>: Should dial-up calls to Internet service providers ("ISPs") be treated by the parties as if they were local and subject to reciprocal compensation for purposes of inter-carrier compensation?

Q. DESCRIBE YOUR UNDERSTANDING OF STAFF'S POSITION ON ISSUE 2.

A. I believe that Staff has advanced the dialog on this issue in a number of positive ways.

Staff correctly recognized that ISP traffic is different from local voice traffic, both from a regulatory point of view and from a network cost perspective.

They correctly recognized that pursuant to the FCC's Declaratory Ruling, ISP traffic is not local traffic, and is, therefore, not subject to the reciprocal compensation requirements of the Act or the FCC's rules.

They correctly recognized that the characteristic hold times of ISP access calls are so much longer than for traditional voice traffic that the costs of handling that traffic are also significantly different, and that (if in fact cost-based inter-carrier compensation were required by the FCC's policies) a failure to accommodate that difference would lead to a systematic overcompensation of Focal. In addition, Staff recognized that Focal's switch does not serve as a tandem in delivering ISP-bound traffic to ISPs, and that therefore tandem switching and transport costs should not be included in any analysis of the costs incurred by Focal in delivering such traffic. Most important, Staff recognized that a systematic overcompensation of Focal would be contrary to the public interest.

Finally, Staff correctly recognized that, given the legal, economic, and public policy imperatives that together establish the extreme importance of doing so, ISP traffic can be adequately identified for separate treatment, particularly if all LECs cooperate. I would also point out that in establishing this principle, Staff and the Commission will provide incentive for all parties in the industry to work cooperatively on ways to improve efficiency and accuracy of the proper identification of this traffic.

However, there are also some areas in which I believe Staff's analysis is inadequate or erroneous.

Q. WITH WHAT AREAS OF STAFF'S RECOMMENDATIONS DO YOU TAKE ISSUE?

A. While Staff seemed to acknowledge that inter-carrier compensation payments for dial-up ISP traffic have a potential impact on retail rates, competitive entry incentives, and rapid, efficient deployment of advanced technologies, I don't believe Staff's recommendations adequately reflect the magnitude and importance of these concerns. This underestimation caused Staff to erroneously conclude that they could adequately address this issue by eliminating any systematic over-recovery of costs via the inter-carrier compensation arrangement between the LEC serving an ISP and the LEC serving the ISP's customer, while continuing to require the second LEC to bear 100% of the costs. I believe that Staff erred in not recognizing that a LEC serving an ISP can, and should, recover at least some (if not all) of its cost of delivering traffic to that ISP through its charges to the ISP. As I stated in my earlier Verified Statement in this proceeding (see p. 7), I believe that such a conclusion would be entirely consistent with the policy considerations underlying the FCC's ESP exemption.

Q. ARE THERE ANY OTHER ISSUES THAT SHOULD BE DEALT WITH IF THE COMMISSION ADOPTS A COMPENSATION ARRANGEMENT IN THIS PROCEEDING SUCH AS THE ONE PROPOSED BY STAFF?

A. Yes. Staff's analysis of costs in this proceeding is based on Focal's representation that it provides service to ISPs using end office switching equipment that is substantially similar to that used by Ameritech Illinois (and Focal) to provide basic voice telephony to end user customers. If any form of cost-based inter-carrier compensation is established in this proceeding, it should be made clear in both the Commission's order and in the resulting agreement that the compensation arrangement is applicable only to the extent that the LEC(s) involved actually employ substantially similar end office switching equipment in serving ISP customers. No other CLEC should be allowed to "opt in" to any compensation arrangement for ISP traffic without showing that its costs can be expected to be consistent with the analysis used in this proceeding, nor should either Focal or Ameritech Illinois be allowed to continue receiving such cost-based compensation if it begins to serve ISP customers using switching equipment that may have different cost characteristics than the typical end office switching equipment that has been at issue here.

Q. BACK TO YOUR FIRST POINT CONCERNING STAFF'S RECOMMENDATION THAT AMERITECH ILLINOIS COMPENSATE FOCAL FOR ALL OF THE COSTS IT INCURS TO DELIVER THIS TRAFFIC, WHAT

IS THE BASIS FOR YOUR DISAGREEMENT WITH THAT RECOMMENDATION?

A. Mr. Phipps makes two statements in his testimony that seem to represent the basis for Staff's recommendations. On page 17 he states "Focal clearly incurs costs associated with routing ISP traffic originating on Ameritech's network, and should have the *opportunity* to recover those costs." [emphasis added] On page 21 he states "Furthermore, my proposed rate allows Ameritech to recover its costs based on the current untimed local calling area rates." I believe Staff's apparent acceptance of these two statements is indicative of the shortcomings of Staff's recommendations.

The compensation arrangement proposed by Staff does not merely give Focal the "opportunity" to recover its costs, it guarantees Focal the recovery of those costs without the need to look to its own customer, the ISP, to provide any portion of that cost recovery. The basic tariff rates for the types of sophisticated business services (e.g. Primary Rate ISDN services and digital trunking) typically used by ISPs have traditionally been priced well above cost in ILEC tariffs. This is one of the ways that the FCC has always expected the costs of ISP traffic to be recovered under its ESP exemption policy. Given that history, it seems reasonable to expect that the rates charged to ISPs by Focal (or any other LEC) should be able to cover at least some of the call delivery costs, while still remaining consistent with the basic principles of the FCC's policy.

On the other hand, the proposal to establish ongoing compensation at a rate of $0.001333 per minute does not, in my view, allow Ameritech Illinois to recover its costs of ISP access calls under its current untimed local calling area rates. While Ameritech Illinois did propose this rate level as a reasonable starting point for a relatively brief phase-down process, it is considerably less appropriate as an essentially permanent arrangement for the full duration of the agreement between Focal and Ameritech Illinois. Compensation paid at that rate would amount to a cost to Ameritech Illinois of almost 3-1/2 cents on a 26 minute ISP access call. That cost would represent over 80% of the revenue that would typically be received for the call. In addition, however, Ameritech Illinois bears the cost not only of providing originating switching for the call, but also of transporting it to Focal's POI, as well as any billing and administrative costs associated with the call. Given these facts, it is apparent that payment of compensation to Focal at the rate proposed by Staff would not even come close to allowing Ameritech Illinois to recover its costs of ISP access calls under its current untimed local calling area rates.

On a broader basis, Exhibit EP-03 to my original Verified Statement demonstrated an overall revenue shortfall of $8.48 per month on a "total service" basis for a residential customer using a second line for ISP access, even assuming no compensation is paid to the LEC serving the ISP. Payment of compensation at the rate proposed by Staff would increase this shortfall to $11.60 per month (an increase of $3.12).

To the extent that these cost and revenue imbalances exist, they represent a significant impediment to the growth of competitive choices for residential customers. CLECs will be reluctant to take on either the liability of customers that are already users of dial-up ISP access, or the risk that current non-users will begin using ISP services that cause an inter-carrier compensation liability. These financial risks also create an incentive that, to the extent that they may choose to begin offering residential services, CLECs will limit consumers' choice of Internet Service Providers to those that are affiliates of, or agree to connect directly to, that CLEC.

Moreover, allowing CLECs to recover their costs from LECs serving end users, while those LECs are unable to recover those costs from the end user, encourages CLECs and ISPs, at least in the short run, to offer dial-up access that is subject to inter-carrier compensation rather than high capacity advanced service links like DSL access.

Q. HAVING REVIEWED STAFF'S PROPOSALS, WHAT ARE YOUR RECOMMENDATIONS TO THE COMMISSION?

A. First, Ameritech Illinois continues to believe that it would be entirely appropriate to immediately establish a policy that no inter-carrier compensation should be paid for ISP traffic, or secondarily to establish a one-year phase-out of such compensation as an alternative.

Given Staff's apparent misgivings over those recommendations, however, I will present one further proposal that I believe may mitigate some of Staff's concerns, while also making some progress towards eliminating the harms that Ameritech Illinois believes are inherent in any arrangement that includes inter-carrier compensation for ISP traffic. I want to make it clear, however, that Ameritech Illinois stands by its belief that no compensation is appropriate and no transition is necessary, and presents this proposal in the belief that if the Commission shares Staff's concerns, those concerns can be accommodated in a manner that is more closely in tune with the long term public policy goal of developing a robust, balanced competitive telecommunications marketplace for all customer segments.

Q. WHAT IS THIS FURTHER PROPOSAL IN RESPONSE TO STAFF'S CONCERNS?

A. The proposal has two parts. Since Staff seems reluctant to commit to the complete elimination of inter-carrier compensation for ISP traffic in this two-party arbitration proceeding (either immediately or with a one-year phase-out), the proposal includes a compensation element that would be in place for at least one year following the effective date of the new agreement between Focal and Ameritech Illinois. It would then provide for the possibility of a change to the compensation arrangement on a going-forward basis that is under the control of the Commission (presuming, of course, that the FCC has not assumed full jurisdiction over this traffic in the interim, in which case the issue becomes moot in any case).

Q. WHAT WOULD BE THE RATE FOR COMPENSATION UNDER THIS PROPOSAL?

A. In acknowledgement of the continuing potential harm to both untimed local calling rates and balanced competitive incentives that would result from a continuing, open-ended obligation to pay inter-carrier-compensation on ISP traffic at a level of $0.001333 per minute, and in acknowledgement also of the ability of any LEC serving an ISP to recover at least some of its costs through charges to its customer (both of which I discussed above), the compensation rate would be set at a lower level of $0.000946 per minute of use. That rate is equal to the cost of the tandem switching element (only) of reciprocal compensation, as adjusted to reflect the impact of a 26 minute average hold time on the allocation of setup and duration costs to a melded per-minute rate. This adjusted tandem switching cost was originally computed by Ameritech Illinois in response to the Focal data request cited by Staff, and it also was shown in Exhibits EP-02 and EP-03 attached to my original Verified Statement.

At that proposed rate, the compensation paid for a 26 minute ISP access call ($0.02496) would be approximately one-half of the basic tariff rate (5 cents) for an untimed local call in the Chicago LATA, though it would represent more than 50% of the actual average per-call revenues received by Ameritech Illinois, due to the application of volume and time-of-day discounts to that basic rate. Thus, it would be consistent with my original recommendation that any compensation paid during the phase-down period should be capped at one-half of the revenues received for an untimed local call. This rate would be in effect for at least one year following the effective date of the agreement.

Q. HOW DOES THIS PROPOSAL ACCOMMODATE THE POSSIBLITY OF A CHANGE TO THE COMPENSATION ARRANGEMENT AFTER ONE YEAR?

A. Ameritech Illinois proposes that the compensation arrangements be subject to renegotiation on 60 days' notice by either party, but with the effective date of any replacement arrangement not to precede one year from the initial effective date of the entire agreement. The parties would then negotiate a replacement compensation arrangement, subject to the dispute resolution process in the agreement with the ultimate possibility of a resolution mediated or arbitrated by the Commission. In order to remove any incentive for either party to slow down the negotiation process for the new arrangement, the agreement should specify that the replacement compensation arrangement would be applied retroactively (if necessary) to the date of cancellation of the initial arrangement.

Q. WHY SHOULD THE COMMISSION BE SUPPORTIVE OF A MECHANISM IN THE AGREEMENT TO ALLOW A MID-COURSE CORRECTION FOR THE COMPENSATION ARRANGEMENTS APPLICABLE TO ISP TRAFFIC?

A. The rate of change in this industry seems to be accelerating each year. Ameritech Illinois believes that even the lower compensation rate specified in this further proposal is likely to create adverse impacts to the potential for balanced competitive entry for all customer segments, the market potential for advanced services, and untimed calling rates. Evidence of adverse impacts in the next year could be greater than expected by Staff and prompt Commission desire to make a mid-course correction. Another possible catalyst for change would be if the typical switch technology used by LECs to serve ISPs were to change quickly, making cost assumptions used in this proceeding (i.e., ISPs served by same technology as ILEC voice customers) no longer valid. Another possible cause would be significant growth in the average hold times of ISP access calls, which would also impact the cost assumptions used here. Additionally, the Commission could be persuaded at some later point that it should investigate this issue on a generic basis with participation from all affected parties, as a number of states have begun to do. Finally, the FCC could issue a ruling that continues to give the states the responsibility for regulating these compensation arrangements, but with associated regulations that are inconsistent with the results of this proceeding. For all of those reasons, I believe that in the context of this proposal, and in the context of the treatment of this issue in a two-party arbitration setting in general, it would be prudent to allow for a change to the compensation arrangements applicable to ISP traffic after a period of one year.

<u>Issue 1</u>: **For purposes of reciprocal compensation, should Focal be compensated for end office, tandem, and transport elements of termination for all local traffic terminated on its network, even if only a small minority of the calls actually terminate to customer premises that are more than a few miles distant from the Focal end office switch?**

Q. DESCRIBE YOUR UNDERSTANDING OF STAFF'S POSITION ON ISSUE 1.

A. First, I wish to make clear the limited context in which I will address this issue. This issue, as addressed in Ms. VanderLaan's Verified Statement and as I will address it here in my Supplemental Verified Statement, is limited to the proper application of tandem switching and transport rates for *local, non-ISP* traffic originating on Ameritech Illinois's network and terminating on Focal's network.

Regarding the application of tandem switching and transport charges on local traffic, Staff appears to take what I believe is an overly simplistic view of both the network arrangements and facilities at issue, and of the FCC's rules as to how this compensation should be administered. As a result, Staff appears poised to recommend that Focal be allowed to demand compensation for tandem switching and transport that it seldom, if ever, actually performs on behalf on Ameritech Illinois. This would permit Focal to receive compensation for costs that it does not incur.

Q. HOW SHOULD THE COMMISSION APPROACH THE DECISIONMAKING PROCESS ON THIS ISSUE?

A. The Commission should first determine the application of rates that would most correctly match up with any costs incurred by Focal on behalf of Ameritech Illinois, without systematically overcompensating Focal for costs it does not incur. The Commission should then order that the parties implement a compensation arrangement that best matches compensation with costs, within the confines of the FCC's Rules.

Q. DO THE FCC'S RULES PRESENT AN IMPEDIMENT TO THE IMLEMENTATION OF COMPENSATION ARRANGEMENTS THAT WOULD PROPERLY MATCH COMPENSATION TO COSTS INCURRED?

A. I don't believe that they do. Focal has attempted to position this issue such that it is required only to meet an arbitrary "geographic coverage" test through a minimal showing, and that for successfully "playing the game" it is rewarded with increased payments from Ameritech Illinois, regardless of whether Focal actually incurs any of the costs which the payments are presumed to cover. I believe that in this instance, the Rules are not an impediment to a proper application of rates consistent with costs incurred. In paragraph 1090 of its Local Competition Order, the FCC allows for both implementation on a functional basis, that is, to look separately at each function (i.e. switching and transport) performed for each call ("states shall also consider whether new technologies … perform functions similar to those performed by an incumbent LEC's tandem switch") and implementation on a call-by-call basis if appropriate ("whether some or all calls terminating on the new entrant's network should be priced the same as the sum of transport and termination"). A proper matching of compensation to costs should look at the functions performed by Focal on a call-by-call basis and provide compensation for the functions actually performed on behalf of Ameritech Illinois.

Q. WHICH FUNCTIONS (IN ADDITION TO END OFFICE SWITCHING) DO YOU BELIEVE ARE PERFORMED BY FOCAL'S NETWORK IN TERMINATING CALLS ORIGINATING ON AMERITECH ILLINOIS'S NETWORK?

A. While I believe it is clear that existing CLEC networks such as Focal's network seldom, if ever, perform a function equivalent to tandem <u>switching</u> (see my original verified statement at pp 25-30), I will concede that there is some uncertainty as to whether CLEC facilities connecting their customers to their switches <u>may</u> <u>sometimes</u> perform a function equivalent to tandem <u>transport</u>. In my view, any "equivalence" would have to include a demonstration that the ILEC actually benefits from this transport (i.e. that using it provides an economic benefit to the ILEC) such that the ILEC ought to willingly pay for it. CLECs willingly choose tandem termination over direct end office termination on the Ameritech Illinois network when they see a net benefit -- even though the per minute cost is higher, the savings in other areas make tandem termination attractive. It is not clear to me that this standard can be met in most cases for calls terminating on a CLEC network, since Ameritech Illinois will often incur additional transport costs hauling the traffic from the local area to Focal's distant switch equal to Focal's cost of hauling the call back to its end user in the local area.

However, given the relatively small cost of transport ($0.000370 per minute for the average 13 miles of transport at the current Commission-approved rates), Ameritech Illinois would be understanding of a Staff (or Commission) determination that Focal should be compensated via tandem <u>transport</u> (nor switching) rates for local (non-ISP) calls that terminate at a point significantly distant from Focal's switch (e.g. more than 4 miles) for the duration of this agreement, without conceding that such compensation is appropriate. Were the Commission to impose that arrangement, Focal would have to be held responsible for accurately determining which calls actually terminate in each local area served by its switches, and in particular properly identifying the actual termination point of "virtual FX" calls.

Q. IS THERE A SITUATION WHERE FOCAL COULD BE ENTITLED TO TANDEM SWITCHING BASED ON FUNCTIONALITY?

A. Yes. Since Focal has two switches, it is conceivable that it could offer to permit "overflow" traffic (i.e. traffic that would otherwise be blocked when all assigned trunk routs are busy) destined for one switch to be optionally (at Ameritech Illinois's choice) delivered to the other switch where Focal would "tandem" it to the destination switch over its inter-switch facilities. I don't know whether Focal offers this capability, but calls using such a capability would be compensable based on Ameritech Illinois's proposed definition of functionality – it is trunk-to-trunk switching, and it can be bypassed at Ameritech Illinois's option. In addition to the tandem switching, the transport between Focal's switches would also be compensable as tandem transport.

Q. ARE YOU AWARE OF ANY OTHER COMPENSATION ARRANGEMENTS ORDERED BY STATE COMMMISSIONS THAT PLACE SOME LIMIT ON A CLEC'S ABILITY TO CLAIM TANDEM AND TRANSPORT COMPENSATION FOR EACH AND EVERY CALL TERMINATED ON ITS NETWORK?

A. Yes. In a recently issued order in an arbitration proceeding involving Ameritech Ohio and ICG Communications, the Public Utilities Commission of Ohio ordered that ICG would be entitled to compensation for tandem switching and transport only to the extent that calls are delivered to it via tandem trunks, and not end office direct trunks, from Ameritech Ohio's network. The idea seems to be to use the relative amounts of tandem-switched and non-tandem-switched traffic passing from ICG's network to Ameritech

Ohio's network as a "proxy" for the amount of traffic in the other direction that should be entitled to tandem switching and transport compensation, and would tend to result in a lower percentage of traffic being paid at the tandem rate over time as the CLEC network grows. While I believe that this Ohio arrangement still systematically overcompensates CLECs for some calls and is therefore less desirable than the arrangement I described above, it is certainly preferable to Focal's proposal (with which Staff appears to be in sympathy) which would systematically overcompensate Focal for a much larger number of calls.

Q. IN RESPONSE TO STAFF'S REQUEST (VANDERLAAN P. 10), PLEASE EXPLAIN WHY THE RATE CENTER DATA PROVIDED BY FOCAL IS NOT AN APPROPRIATE PROXY TO SHOW GEOGRAPHIC TRAFFIC DISTRIBUTION.

A. The rate center data provide absolutely no information about either the number of customers, the number of lines serving those customers, or the volume of traffic terminated to those customers. Thus, it is subject to a "gaming" behavior in which just enough apparent "geographic distribution" is created to enable the CLEC to capture the right to charge tandem switching and transport rates for a much larger volume of non-geographically-dispersed traffic that would otherwise not appear to merit such compensation. As I stated in my original Verified Statement, "Any standard less stringent that a full demonstration of traffic distribution for each switch would simply be an open invitation to "gaming" the rules in search of an undeserved windfall by Focal and other CLECs. If Focal were to be paid tandem-based rates without actually incurring any tandem or transport costs, then Focal would be receiving a subsidy at the expense of Ameritech Illinois and its customers. Granting Focal such a subsidy would encourage Focal and other CLECs to design their networks based not on efficiency but rather on whatever arrangement generated the greatest subsidy."

As I discussed above, Ameritech Illinois believes that the public interest will be best served by ensuring that Focal is compensated, on a call-by-call basis, for only those costs that it actually incurs in terminating traffic originated by customers on Ameritech Illinois's network.

Q. DOES THIS CONCLUDE YOUR VERIFIED STATEMENT?

A. Yes.

State of Illinois)
)
County of Cook)

VERIFICATION

I, Eric L. Panfil, being first duly sworn, do on oath depose and state that I have read the foregoing Verified Statement, am familiar with the contents thereof, and that such contents are true and correct to the of my knowledge, information and belief.

ELPanfil

Eric L. Panfil

Subscribed and Sworn to before me this 6th day of March, 2000.

Diane M. Biasella

Notary Public

OFFICIAL SEAL
DIANE M BIASELLA
NOTARY PUBLIC, STATE OF ILLINOIS
MY COMMISSION EXPIRES:08/20/00